



Dogfight at the WTO

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In the autumn of 1999 Phil Condit, then the chief executive of Boeing, travelled to Washington for a meeting with the US government that was supposed to launch the biggest dispute ever to be put to the World Trade Organisation.

The executive council of the world's largest aircraft maker had authorised Mr Condit to support President Bill Clinton's administration in filing a WTO case aimed at preventing European governments from providing more than \$3bn to help Airbus launch the A350 - a 555-seat jet that would compete with Boeing's ageing flagship, the 747.

Since its formation in 1970 as a consortium of European aerospace companies, Airbus had steadily eroded Boeing's dominance in the large civil aircraft market, in part thanks to generous European support. By 1992, when the US and EU negotiated a bilateral agreement to restrain such subsidies, Airbus had captured 30 per cent of the world market. By 1999 Airbus was poised to overtake Boeing as the market leader.

According to people with knowledge of the meeting, it included Mr Condit; Charles Barshefsky, the US trade representative under Mr Clinton; and Robert Novick, Mr Barshefsky's general counsel.

Ms Barshefsky was worried that Boeing might get cold feet. She wanted Mr Condit to give her assurance that, if the US filed such a contentious dispute, the company would stand behind the government every step of the way.

Several times Ms Barshefsky asked for such a commitment - and each time Mr Condit changed the topic. In the end, he told her he had not made up his mind. When Mr Condit departed, Ms Barshefsky turned to Mr Novick and said: "What was that all about?" Plans to file a case were quietly shelved.

Four years later - and after more than a decade when Washington and Brussels agreed to turn a blind eye to government support given to both Airbus and Boeing - the administration of President George W. Bush has called an end to the truce.

The US trade representative's office on Wednesday requested consultations under the WTO, alleging that European governments had provided more than \$15bn in illegal launch aid to allow Airbus to supplant Boeing. Ms Barshefsky and Mr Novick, now in private law practice, have been hired by Boeing to help the Bush government case. The EU responded by filing a counter-case against Boeing, alleging it had received more than \$23bn in subsidies through government research and development programmes.

If the two sides cannot resolve the dispute bilaterally, dispute settlement panels will be formed. A resolution under the WTO could result in billions of dollars in trade penalties that could drive a stake into the world's largest bilateral trading relationship. The dispute will force both sides to grapple with politically-charged decisions over when to curb government support to such high-profile companies.

The question that arises is why the US is prepared to take such a risk now. Robert Zoellick, the US trade representative, and Pascal Lamy, the EU trade commissioner, established over the past four years a close relationship that allowed them to defuse pressures of domestic interests and smooth the trade waters. They resolved a long-standing dispute over bananas, avoided escalating a row over genetically modified foods, collaborated in easing and then ending US tariffs on steel and helped put the "Doha Round" of world trade negotiations back on track.

But that special relationship appears to have counted for little this time. Mr Lamy made a final plea last week when he met Mr Zoellick in Washington and offered to continue negotiations on a new bilateral agreement to restrain government subsidies on both sides. EU officials said Mr Zoellick refused outright; US officials say Mr Lamy's proposal did not meet the threshold of barring future subsidies.

Two senior Airbus officials were similarly rebuffed in meetings in Washington last week. "They came away feeling it was like 1914, when everybody is going to war but nobody knows why," said one Airbus official.

The row comes at a particularly awkward time, since both the US and the EU are about to replace their leading trade officials soon. Mr Zoellick is likely to leave whatever the outcome of the US presidential election, while the dispute will be a baptism of fire for Peter Mandelson, who is set to become the EU's trade commissioner next month. On Monday, at a confirmation hearing before the European Parliament, Mr Mandelson

former British minister and ally of Tony Blair, the UK's prime minister - presented conciliatory approach towards the US, urging the Bush administration to keep the aircraft dispute "out of the WTO net" and playing down the significance of recent trade spats.

Airbus and EU officials charge that the WTO case is the result of a sordid marriage of interests. Boeing, they say, is hoping to deflect attention from the defence procurement scandals plaguing the company by attacking Airbus on subsidies. And the Bush administration, they charge, wants to curry favour in states where Boeing is a large employer and thereby counter charges from John Kerry, the Democratic presidential candidate, that Mr Bush is soft on trade enforcement.

"The issues are relatively old and there is nothing new here," says Konstantinos Adamantopoulos, head of the Brussels trade law office at Hammonds, the law firm. "What has triggered this now? It is political probably. I would not blame it on [Z and Lamy's] relationship but this is election time in the US and that matters."

US officials challenge those claims, saying the dispute is driven by Boeing's commercial considerations. In particular, Boeing wants to prevent Airbus from developing a subsidised competitor to its 7E7 "Dreamliner" jet, a mid-sized, long-range aircraft that has attracted some strong initial orders. Trade officials point to an interview last year in which Noel Forgeard, the Airbus chief executive, told *Les Echos*, the Financial Times' French sister newspaper, that the company was prepared to launch a direct competitor to the 7E7 and might seek launch aid under the terms of the 1992 agreement.

"What is so pernicious about launch aid is that it is risk-free money," said a senior US official. "If the plan is successful, great, but if it is not the launch aid loans do not have to be repaid."

Unlike four years ago, there is little question that Boeing is firmly committed to the WTO case. Mr Condit feared that a WTO case could alienate the company's European customers and prove a distraction from his own strategy of diversifying the company by moving into the satellite business and grabbing a larger portion of Washington's growing defence budget. But he was forced out this year after scandals in those divisions left that strategy in tatters. Harry Stonecipher, a former Boeing executive who was hauled out of retirement to take over from Mr Condit, believes the company will recapture its dominant position in the civil aircraft market.

The two men offer a sharp contrast. Mr Condit was an internationalist who served as the US chair of the Trans-Atlantic Business Dialogue, a group aimed at fostering resolution of US-EU commercial disputes. He surrounded himself with an executive

council of 28 members who met every month, a system that critics say paralyses decision-making. Mr Stonecipher is a no-nonsense Texan who cut the executive from 28 to 12 and pledged to return to Boeing's core strategy of dominating in military and commercial aerospace business. With only two years until his promised retirement at 70, he does not have much time to turn the company round. "Often people describe me as risk-averse," he said in an interview with the FT earlier this year. "Nothing can be further from the truth."

While Boeing's goals seem clear, the US government strategy is less so. Many trade experts are puzzled by how quickly the US has thrown this dispute into the WTO since Mr Stonecipher revived the issue. A victory in the WTO would only benefit the US if it forced the EU to negotiate fresh constraints on government subsidies for future aircraft. Brussels negotiators claim that Washington turned down earlier requests to review the terms of their 1992 bilateral agreement on aircraft subsidies. While the two sides held discussions in July and September this year, talks towards a new agreement had barely begun. Yet Mr Zoellick continues to insist that the US is hoping for a negotiated deal. "The US remains interested in an agreement that ends all new subsidies," he said in a statement. "So as this case proceeds, we remain open to negotiating a new accord."

US trade officials say they are confident of their case. The US filing this week alleges that the EU has violated a range of WTO restrictions on subsidies by financing projects that would otherwise not be commercially feasible.

The EU is equally confident that Boeing has been on the receiving end of illegal subsidies. Brussels claims that Boeing has benefited substantially from over-priced defence procurement contracts, as well as preferential access to military and aeronautical research programmes. One recent example given is the terms agreed for the sale of 767 refuelling aircraft. Brussels cites a Morgan Stanley report that found the normal profit margin for the 767 to be 6 per cent, whereas the Pentagon planned to give Boeing up to 15 per cent.

The EU also plans to challenge the financing Boeing has lined up for its 7E7 project. Washington state, in the US north-west, has offered about \$3bn in tax reductions related to 7E7 production. In a recent note the European Commission said: "Washington state 7E7 subsidies alone are about as high as European launch investment for the A380. The only difference is that A380 launch investment is paid back and is consistent with the 1992 agreement, while Washington's support is not."

The most likely outcome of the WTO cases is what EU officials referred to in an internal memo obtained this week by Bloomberg News: "mutually assured embarrassment".

which both sides lose before the WTO and neither wants to come into compliance.

Lode Van Den Hende, a trade lawyer at Herbert Smith in Brussels, said: "Both the US and the UK seem to have systems in place that could be viewed as subsidies. The aircraft subsidy dispute between Canada and Brazil ended up with a situation where both parties were found in breach and from what I can see the situation looks similar."

The dogfight between Canada and Brazil may prove instructive. In 1996 and 1999, both countries filed similar WTO cases. Canada wanted to end Brazilian government subsidies for Embraer, the regional jet maker that was taking a growing number of orders from Bombardier, the market leader. Brazil responded by filing a similar case alleging Canadian government subsidies for Bombardier.

The WTO found fault on both sides and each threatened billions of dollars in trade sanctions as a consequence. But neither side was prepared to use sanctions that would have cut off bilateral trade. Nor was either side prepared to back away from supporting its flagship aircraft makers.

"You had these two bulls in a deadlock, looking each other in the eye to see who would move first," says Andre Lemay, a Canadian trade official. "In the end we both said 'nuts.'"

Indeed in 2001 Canada decided to mimic the Brazilian support scheme in violation of the WTO ruling it had already won, offering a cut-rate loan of \$1.75bn to Air Canada, the US carrier, to persuade it to buy Bombardier rather than Embraer jets. The two sides are sitting down in Ottawa next week as part of continued, but so far fruitless, efforts to restrain subsidies.

In the case of Boeing and Airbus, some trade analysts fear that the result could be similarly futile. However, Brendan McGivern, a WTO lawyer with White & Case in Geneva, said a WTO ruling - even if it condemned both sides - could help the US negotiate an acceptable bilateral deal. "WTO obligations could focus the bilateral negotiations in a way that may not be possible at the moment," he said.

Can the WTO take the dispute in its stride? "There shouldn't be any problem for the dispute panel to grapple with this," said one Geneva-based trade expert. "The WTO has built up a fair body of case law on subsidies over the past 10 years, and it has also become quite accustomed to very large commercial disputes involving billions of dollars."

Others are not so sure that the WTO could emerge unscathed from such a transaction.

clash. "It should be settled by diplomacy," says Claude Barfield of the American Enterprise Institute. "I think this is the classic case where the elephants fight and mouse gets crushed."

Additional reporting by Caroline Daniel and Frances Williams

Why has the US filed this case?

The US says European government support for Airbus is no longer justified because the company has developed from being an upstart competitor to Boeing to a group that holds the majority of the world's civil aircraft market. It wants the European Union to agree to end all subsidies before Airbus goes ahead with a competitor to Boeing's 'Dreamliner', a mid-sized long-range jet that is Boeing's first aircraft launch in more than a decade. The two sides had agreed to restrain subsidies in 1992 after the US filed a case in the General Agreement on Tariffs and Trade, the predecessor to the World Trade Organisation. Since that deal, the Airbus share of the world market has risen from 18 per cent to 54 per cent.

Why won't the EU agree to end subsidies?

The European Commission says it is eager to negotiate a new agreement to restrict government subsidies, and indeed made such a proposal earlier this year. But it says the US must agree to stop 'indirect' US government support for Boeing and must allow billions of dollars in aid already pledged by Washington state for the 7E7. The EU says that funds already pledged, such as those for Airbus's jumbo A380 and Boeing's 7E7, should remain in place, while future subsidies should stop.

Which is getting the biggest subsidies, Boeing or Airbus?

It depends on who you ask. The US says that Airbus has received at least \$15bn in 'launch aid' from the UK, France, Germany and Spain. That launch aid provides interest rates that are below market and the money is repayable based on future sales of aircraft. An unsuccessful launch would result in forgiveness of the loan. Boeing says Airbus has avoided \$35bn in debt, which the company would otherwise have incurred by borrowing at normal market rates. The EU says that Boeing has received about \$23bn in US subsidies since 1992, largely through research and development programmes funded by the Pentagon and NASA. The EU plans to challenge aid pledged to the 7E7, which includes a \$3.2bn tax reduction over 20 years from the state of Washington for production related to the 7E7.

What is the WTO likely to rule?

WTO dispute settlement panels are hard to predict, but if history is any guide, blame will be found at fault. Canada and Brazil launched WTO cases in 1996 and 1997 challenging similar sorts of government support for Bombardier and Embraer, the makers of smaller regional jets. The WTO found fault with both countries but either later neither has agreed to end subsidies to their aircraft companies.

What happens next?

Under WTO rules, the two sides are obliged to spend 60 days in consultations to reach a negotiated solution. If that fails, as seems likely, they can agree to extend the consultation period or request the formation of a dispute settlement panel. The decisions usually take a year or more. After that, either side can appeal to the WTO appellate body, a step almost always taken in high profile disputes.

Who else gets hurt?

The dispute could complicate the financing of aircraft purchases for the already beleaguered airline industry. It will also create uncertainty for a host of suppliers working for both companies. Six US companies are involved in the A380 program including General Electric and Honeywell, while Rolls-Royce and GKN are among European companies that are set to take part in the 7E7's development. Finally, the dispute is likely to affect other US companies, in sectors such as wood products, heavy machinery and jewelry, which are facing escalating trade sanctions from the EU as part of an unrelated dispute over a US corporate tax subsidy. The US Congress is poised to lift the tax subsidy, which should lead to a lifting of sanctions, but the EU had warned it might keep the sanctions in place if the US filed a WTO case against Airbus.

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